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INVESTORS SERVICE

OUTLOOK
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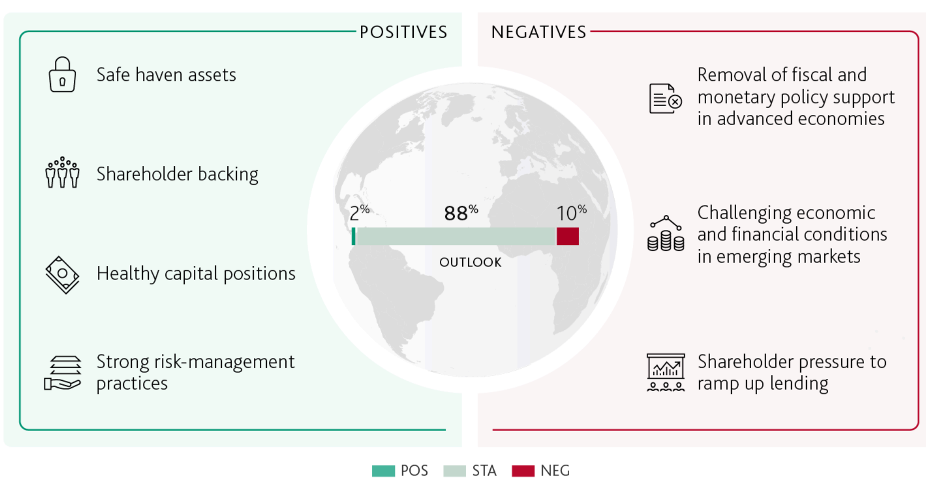
Multilateral development banks – Global

2022 outlook is stable given resilience to challenging economic and financial conditions in emerging markets

Our outlook for multilateral development banks (MDBs) and other supranational entities for the next 12-18 months is stable. The ongoing challenges in weaker emerging markets and withdrawal of policy support by governments will pose challenges to MDBs' asset quality and performance in 2022. However, strong risk-management practices will limit material deterioration in asset quality to those MDBs with concentrated loan portfolios and greater exposure to the private sector. Moreover, liquidity buffers remain solid as most MDBs were able to fund themselves on financial markets at very low costs during the pandemic. Although calls from G-20 governments for MDBs to ramp up their lending will intensify in the coming years, strong shareholder support and the increased use of risk mitigation and credit-enhancement instruments will limit associated pressure on capital positions. At the same time, the pandemic has underlined the importance of the MDB sector as counter-cyclical financiers in a crisis and for some has actually helped raise their profile to shareholders and other sponsors.

Exhibit 1
The interplay of several drivers underpins our stable outlook on MDBs in 2022



Source: Moody's Investors Service

The stable sector outlook reflects our view of credit fundamentals for MDBs over the next 12 to 18 months. Sector outlooks are distinct from rating outlooks, which, in addition to sector dynamics, also reflect issuers' specific characteristics and actions. A sector outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of rating outlooks.

Ratings overview

Despite continuing financial pressures related to the pandemic, all of our rating actions in 2021 on MDBs were neutral or positive.

» We changed the rating outlook of ECOWAS (Economic Community of West African States) Bank for Investment and Development (EBID, B2 stable) to stable from negative to reflect a number of measures to improve its liquidity framework and funding sources.

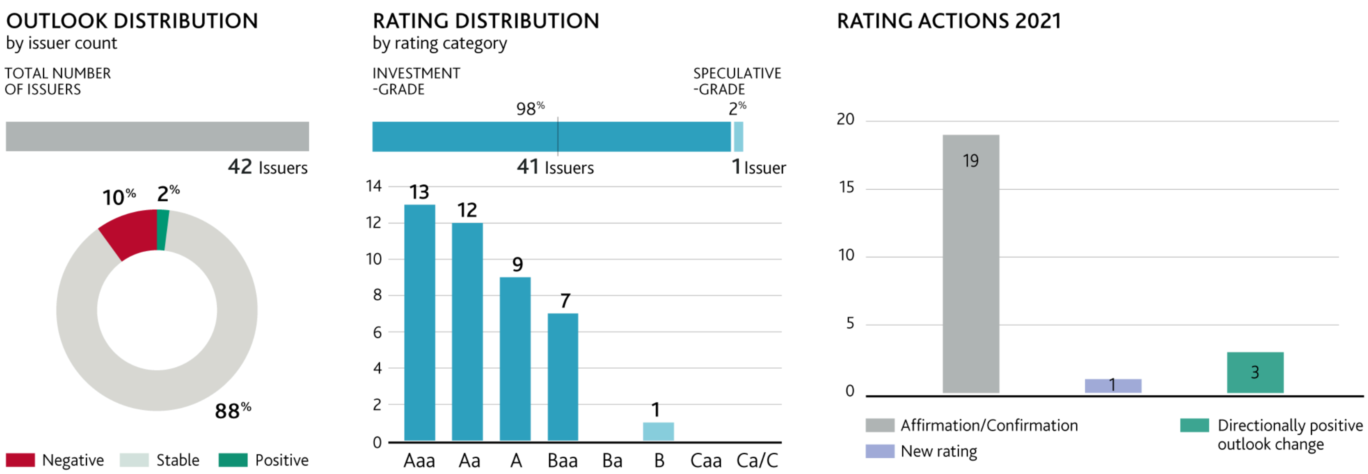
» The stabilized outlook for Africa Finance Corporation (AFC, A3 stable) reflects its resilience to a challenging operating environment.

» We changed the rating outlook to positive on International Bank for Economic Co-operation (IBEC, Baa3 positive) to reflect the strengthened liquid assets buffer and further diversification of its funding sources.

» We also assigned a first-time rating to The Currency Exchange Fund NV (TCX, A1 stable), a specialized finance vehicle which provides currency hedging on illiquid currencies to its investors, which include MDBs and microfinance institutions.

As a result, 88% of the MDBs we rate now carry a stable outlook. Two of the four negative outlooks held by MDBs reflect risks linked to a large concentration to low-rated borrowers: more than 10% of the loan portfolio of West African Development Bank (BOAD, Baa1 negative) is exposed to Mali (Caa1 stable), and Eastern and Southern African Trade and Development Bank (TDB, Baa3 negative) is materially exposed to Zambia (Ca stable). The negative rating outlook on GuarantCo (A1 negative) reflects a rise in leverage in recent years and the pandemic's potentially delayed impact on asset performance. The negative rating outlook on North American Development Bank (NADB, Aa1 negative) captures risks linked to potential regulatory changes in Mexico, its main country of operation. Moreover, nearly 60% of the 42 MDBs we rate are positioned at Aa3 or above, reflecting their important role in achieving the development mandates of their shareholder governments, which often provides uplift above their standalone financial strength.

Exhibit 2
Most rating outlooks are stable, almost all ratings are investment grade and the rating actions we took last year were all neutral or positive



*Source: Moody's Investors Service. *Universe comprises 39 MDBs and 3 other supranational entities.*

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Leverage trends will vary by MDB after contained increase due to pandemic

MDBs face calls from G-20 governments to scale up MDB financing through balance sheet optimisation, which will exert some upward pressure on leverage. However, trends will vary by MDB depending on planned or anticipated capital increases, room within internal capital thresholds and the use and effectiveness of credit-enhancement instruments.[1]

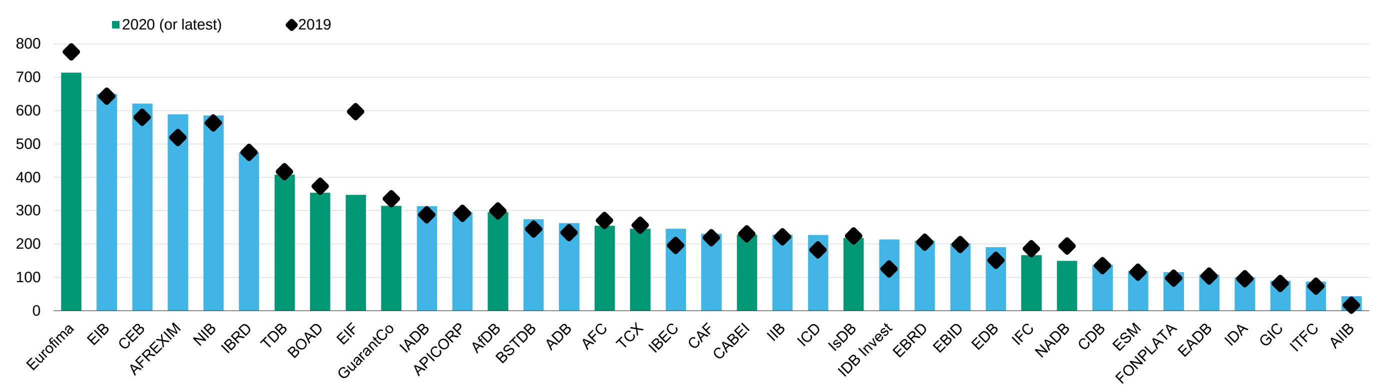
» **Swift pandemic response underlines most MDBs' role as countercyclical financier in a crisis.** MDBs responded to provide liquidity support and finance health and social spending for borrowers. For most, this response did not contribute to a material increase in leverage during the course of the pandemic (see Exhibit 3). Moreover, for the large MDBs that provided most in terms of financial support, this rapid response has helped to reinforce their importance to shareholders and our assessment of the likelihood of further support if needed.[2] For some like the African Export-Import Bank (Afreximbank, Baa1 stable) and AFC the swift response has helped raise their profile with shareholders and other financial supporters.

» **Leverage will remain stable for most large and highly rated MDBs.** Most of these banks are highly leveraged; their ratings are supported by other credit characteristics including very strong asset performance reflecting their preferred creditor status, prudent liquidity and risk management and very solid shareholder support. Ongoing capital increases will allow entities like the African Development Bank (AfDB, Aaa stable), the International Bank for Reconstruction and Development (IBRD, Aaa stable) and the International Finance Corporation (IFC, Aaa stable) to continue to increase their lending operations while remaining safely below their internal leverage or gearing limits. Meanwhile, we expect MDBs with a regional focus on Latin America to maintain their long-standing low and stable leverage ratios. Entities like the Asian Infrastructure Investment Bank (AIIB, Aaa stable) and International Development Association (IDA, Aaa stable) still have ample room to raise leverage given their large capital buffers.

» **Some smaller MDBs will increase leverage from already elevated levels.** Some like AFC, GuarantCo and IBEC have already outlined an increase in lending in their strategic plans. Although some have obtained loans or other types of funding from development finance institutions or non-regional governments, we do not consider that these instruments have the same capital protection characteristics as equity. In several cases, we make an explicit downward adjustment for the anticipated increases in leverage like for Black Sea Trade and Development Bank (BSTDB, A2 stable), EBID, FONPLATA (A2 stable), GuarantCo and IBEC.

» **A small number of highly leveraged MDBs that saw strong lending growth during the pandemic will rein in loan growth this year.** Afreximbank and Council of Europe Development Bank (CEB, Aa1 stable) are some of the most highly leveraged MDBs we rate. We expect CEB to return to pre-pandemic rates of loan growth rate in 2022, while Afreximbank's capital position remains supported by high profitability and by the prospect of new equity injections in 2021-26 approved by the board of directors in June 2021. The European Investment Bank (EIB, Aaa stable) will decrease leverage in 2022.

Exhibit 3
Leverage trends vary significantly across the MDBs we rate
Assets/useable equity, %, green denotes a fall in leverage between 2019 and 2020



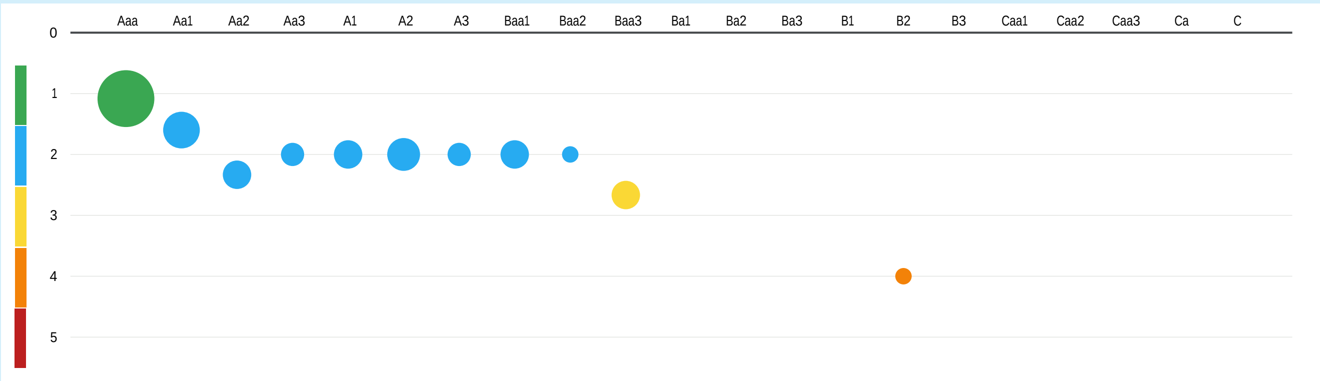
Source: MDBs' financial statements, Moody's Investors Service

- **Climate-related financing and alignment with Paris Agreement goals will increasingly drive lending decisions among larger banks**. MDBs are already among the largest financiers of climate adaptation and mitigation and their role as standard-setters for reporting and impact measurement will only grow in the coming years. MDBs will also be asked to help developing countries prepare for future pandemics and to invest in their health care systems.[3] While current capital increases for IBRD, IFC and AfDB are indicative of shareholders' willingness to provide support, G-20 governments are increasingly focused on how to scale up MDB financing by optimizing their existing capital buffers to allow for greater lending through this channel, rather than relying on governments whose own inflated debt levels constrain their capacity.
- **Use of credit-enhancement instruments and hybrid capital is likely to increase**. MDBs will look to mitigate the associated risks by using risk-mitigation and credit-enhancement instruments, such as synthetic securitizations, credit insurance, and exposure-exchange agreements. Their ultimate impact on an MDB's credit profile depends on the size of the instrument relative to the overall asset portfolio and how effective the mechanism is in reducing the risk. Innovative forms of funding will also increase further. For example, several development finance institutions and governments have provided subordinated debt facilities to GuarantCo and TCX which we consider to have some loss-absorption features similar to equity. MDBs are also likely to issue hybrid securities and subordinated debt facilities because they allow new sponsors to support an MDB's development mandate without necessarily becoming a shareholder in the entity. The equity content we assign to each instrument will depend on the extent to which it provides financial protection to an MDB in a stress situation.

Box 1: Environmental, social and governance (ESG) factors have a neutral and in some cases positive impact on MDB credit quality

- For most MDBs, portfolio diversification across sectors and countries and strong risk-management practices limit the risks associated with their borrowers' exposure to environmental risks. Risks are greatest for those MDBs with concentrated exposures to sovereigns with negative environmental Issuer Profile Scores (IPS)[4] like the Caribbean Development Bank (CDB, Aa1 stable) or Arab Petroleum Investments Corporation (APICORP, Aa2 stable).
- Exposure to social risk is neutral to low. For nine MDBs,[5] however, social factors have a positive influence because their policy mandates often focus on key development challenges like education, poverty reduction and supporting private-sector development.
- Exposure to governance risks is mostly neutral-to-low or positive. A track record of strong risk-management practices (which limit financial risks) is usually the key differentiating factor between a G-1 IPS and a G-2 IPS.

Exhibit 4
ESG factors largely have a neutral or supportive credit impact for rated MDBs



Location and color of each bubble indicate the average credit impact scores[6] for the scored issuers in a given rating category. Size of each bubble indicates the number of scored issuers in a given rating category. 1 is Positive, 2 is Neutral-to-Low, 3 is Moderately Negative, 4 is Highly Negative and 5 is Very Highly Negative.
Source: Moody's Investors Service

Deterioration in asset quality is a moderate risk for some undiversified MDBs

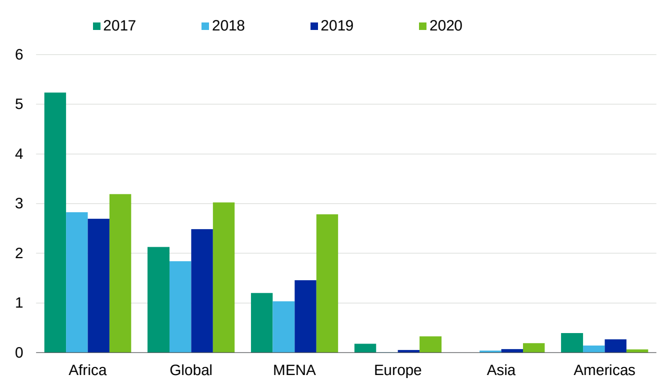
Prudent lending and strong risk management will contain any significant deterioration in asset quality metrics. However, those MDBs with large lending exposures to Latin America and Africa and relatively undiversified portfolios, along with larger private-sector loan exposure, are most vulnerable to the pandemic's lingering effects, relatively weak economic growth in many borrowing countries and tightening financing conditions

» **Asset performance to date has been strong**. Continuing forbearance and moratoria, monetary and fiscal stimulus in advanced economies and the relatively strong growth recovery in 2021 helped to limit financial stress among MDB borrowers (see Exhibit 5). Although nonperforming assets (NPAs) increased significantly in 2020 for MDBs that predominantly lend to the private sector and have relatively large equity investments like the IFC, EBRD and Gulf Investment Corporation (A2 stable), the strong rebound in emerging market equity markets and currencies during 2021 brought about a swift reversal in their mark-to-market losses. NPAs increased sharply for those MDBs with concentrated loan portfolios like the African Local Currency Bond Fund (ALCB Fund, Baa2 stable) who was impacted by defaults on several of the fund's corporate bond portfolio holdings. Downgrades to sovereign ratings in 2020 and challenging economic conditions worsened asset quality for those MDBs with greater exposure to Africa and Latin America. However, the credit quality of most MDBs' portfolios has generally since stabilized.

» **The pandemic could still test the asset performance in 2022.** An uneven recovery exposes some borrowers to challenging economic environments. Inflationary pressures building in a number of countries may also be a source of financial stress. In addition, a change in US monetary policy is likely to worsen financing conditions in emerging markets. That said, we do not expect a rapid or generalized rise in NPAs in 2022. Most MDBs have strong risk-management practices, many have increased their provisioning levels in 2020 and those at the higher rating levels in particular have ample leeway to work out troubled exposures over time. Moreover, the crisis has largely reinforced the preferred creditor status of MDBs who lend mostly to sovereigns.

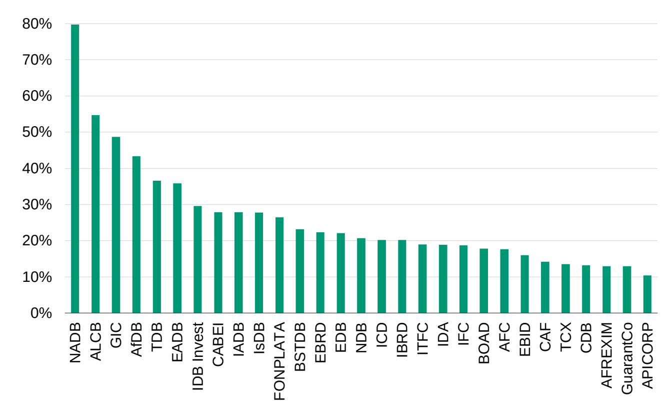
» **Risks to asset quality and performance are greatest for those MDBs whose loan portfolios are relatively undiversified, heavily exposed to the private sector and to sovereigns under pressure**. MDBs with portfolio exposure to countries with a negative sovereign outlook (see Exhibit 6) include NADB,[7] ALCB Fund, GIC, TDB and East African Development Bank (EADB, Baa3 stable). However, we account for these risks in our ratings for a number of African-focused MDBs as well as the Caribbean Development Bank (CDB, Aa1 stable). By contrast, the AfDB is better diversified across sovereigns and corporate sectors.

Exhibit 5
Asset performance has deteriorated in most regions, but remains strong for most MDBs
Nonperforming assets, % of total



Source: Moody's Investors Service

Exhibit 6
A number of MDBs are vulnerable to a further deterioration in asset quality
Portfolio exposure to countries with a negative sovereign outlook, % of total development-related assets



NADB, ALCB Fund and GIC have only exposures to the private sector.
Source: Moody's Investors Service

Robust market access and liquidity during pandemic bodes well for resilience to future shocks

Despite a likely deterioration in financing conditions for emerging markets and the gradual normalization of monetary policy this year, MDBs remain safe-haven assets in financial markets. MDBs have also retained solid liquidity buffers, with several receiving additional funding. The combination of very strong market access and sound liquidity buffers is sufficient to limit liquidity pressure in the face of market volatility.

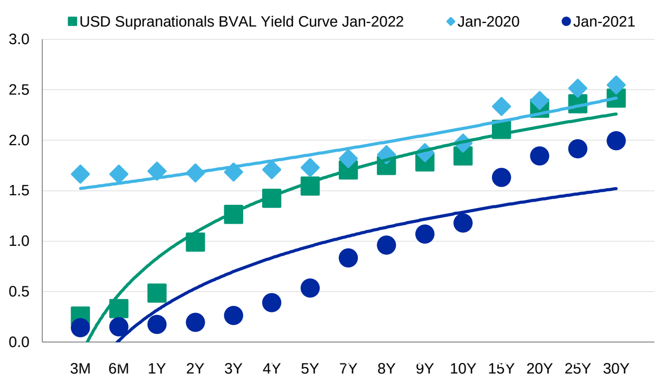
» **MDBs have maintained very favorable borrowing costs during the course of the pandemic.** Despite higher-than-normal levels of borrowing to support expanded lending capacity, a flight to quality during the pandemic saw bond yields at the shorter end of the curve (0-5 years) fall for most MDBs to below pre-pandemic levels (see Exhibit 7). In line with other risk-free assets like US (Aaa stable) Treasuries, inflationary pressures and expectations of a more rapid normalization of monetary policy meant yields have risen at the longer end of the curve from the lows seen in early 2021, but even there yields remain in line with pre-crisis levels. MDBs' ability to retain such favorable funding during severe shocks reinforces the strong "quality of funding" assessments we assign to most MDBs we rate: the median "quality of funding" score assigned to the MDBs we rate is "aa".

» **Liquidity buffers are robust.** Moreover, even if market conditions worsened, most supranational issuers would be able to fulfill their development role. Assuming a stress scenario in which MDBs lost market access and shareholders did not respond with capital support, most MDBs have enough high-quality liquid assets (rated A2 or higher) to cover more than 18 months of net outflows.[8] With the exception of six issuers, all rated MDBs have liquidity above 12 months' net cash outflows; most MDBs determine their liquidity policy as a minimum of 12 months cash needs (see Exhibit 8). EBID and BSTDB have among the weakest liquidity positions compared to other MDBs, with highly rated liquid assets sufficient to meet less than 12 months of net cash outflows.

Exhibit 7

Although yields have increased from pandemic-driven lows, borrowing costs remain very favorable

%

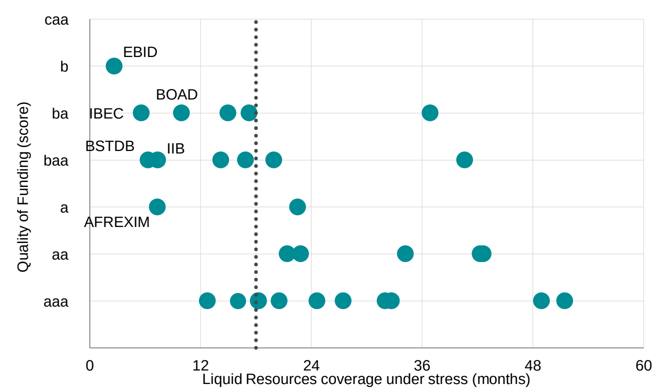


Yield curves built from aggregate of Aaa-rated supranational issuers' USD bonds at different maturities. Light blue line shows pre-pandemic yield levels. Dark green line shows current yields.
Sources: Bloomberg and Moody's Investors Service

Exhibit 8

Most MDBs have very strong liquidity coverage and market access

Scores for quality of funding and coverage in months provided by liquid assets in stress scenario (latest available)



Moody's Liquid resources ratio measures the coverage provided by a supranational's high quality liquid assets (A2 or higher) relative to its projected net outflows for the next 18 months under a stress scenario where the issuer does not receive any capital from its shareholders and does not access markets.
Source: Moody's Investors Service

Moody's related publications

Sector In-Depth

» Multilateral Development Banks - Global: ESG credit impact is neutral for most, positive for many MDBs, 18 January 2022

Outlook

» Sovereigns – Global: Stable 2022 outlook as economic recovery eases credit pressures, but long-term costs of the pandemic weigh on sovereigns, 3 November 2021

» Emerging Markets – Global: 2022 Outlook – Multispeed recovery with stark differences across regions and sectors, 10 November 2021

Rating methodology

» Multilateral Development Banks and Other Supranational Entities, 28 October 2020

Endnotes

1 Credit-enhancement tools include guarantees, insurance, securitization, exposure exchange agreements and callable capital enhancements, which MDBs use to crowd in private capital or reduce capital consumption. For more information, see our report "Supranationals – Global: Gains from MDB credit enhancement tool vary with scope, effectiveness and usage".

2 Recent capital increases for IBRD, IFC and AfDB are indicative of strong shareholder support. This support assessment is a key factor providing uplift from standalone financial strength of a number of Aaa-rated MDBs.

3 See e.g. Rethinking Multilateralism for a Pandemic Era.

4 Issuer profile scores (IPS) are Moody's opinions of an issuer's or transaction's exposure to environmental, social and governance considerations. The IPS incorporate meaningful mitigating or strengthening actions related to those specific exposures.

5 Many of the largest global MDBs like the IBRD, IFC, IDA, and regional MDBs like AfDB, the European Bank for Reconstruction and Development(EBRD, Aaa stable) and the Inter-American Development Bank (IADB, Aaa stable) have positive social IPS scores.

6 Credit impact scores (CIS) communicate the impact of ESG considerations on the rating of an issuer or transaction. The CIS are based on our qualitative assessment of the impact of ESG considerations in the context of the issuer's or transaction's other credit drivers that are material to a given rating

7 As of now, NADB has no nonperforming exposures. However, potential changes to the regulatory framework of the energy sector in Mexico, its main country of operations, could negatively weigh on the performance of a sizeable portion of NADB's loan book dedicated to wind and solar energy in the country.

8 Net outflows cover debt service and administrative expenses and assume planned disbursements remain unchanged.

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